

Adrián NAGY
Gergő KUN
Veronika FENYVES

Faculty of Economics and Business, University of Debrecen, Debrecen, Hungary

FRANCHISE FROM FAMILY BUSINESS?

Empirical
study

Keywords

*Franchise,
Family business,
Enterprise*

JEL Classification

L84

Abstract

The purpose of this study was to examine the franchise as a form of enterprise in perspective to existing family businesses and how can they operate this way. Why is this form better for them, what advantages it has? In this case an ice cream shop's economic indicators were examined, one which is owned by a hungarian family in Jász-Nagykun-Szolnok county who runs several shops like this. That is why this study was made, to find out if it is possible to run it successfully and what costs does the newcomers in the franchise business network have to pay and how much is the time on the return of investments.

RAISING THE TOPIC

This study focuses on the topic of franchise and franchising, namely I concretely seek answers to whether a traditional family undertaking can be developed into a franchise enterprise and, if so, how franchising.

Otherwise, a franchise system can be imagined as a family model where the franchisor i.e. the parents and the franchise recipients i.e. the children live in a close connection and it works as a family undertaking, the investment of which is the child and the company deals with improving him/her.

The thought often emerges that the family undertakings are not professional, not modern but alien to life insofar as we investigate their operations from the aspect of business studies and, moreover, these ones contradict common sense. Spreading these opinions is queried by only one undeniable fact queries, namely that the family undertaking is the most effective and most important form of enterprises in almost every national economy of the world (Bajmócy - Lengyel – Málovics).

Although by now, the traditional Hungarian catering and confectionery have been slightly devalued within the family undertakings because they are not able to compete with the productive global corporations due to the specific consumer habits. And the situation is made worse by that the laws protecting small investors and the aid concerning them are not properly elaborated. But the Economic Development and Innovation Operative Programme of the seven Hungarian operative programmes adopted to date by the European Commission may be a considerable aid to participants of the Hungarian SME sector, moreover, the total allocation of this operative programme is by far the biggest i.e. HUF 2733 billion for seven years (Portfolio.hu, 2015).

MATERIAL AND METHOD

During the research serving as the basis for the topic, we have used primary and secondary research results as well. In the course of the secondary research, we have examined the peculiarities of franchise systems based on the available specialized literature, both in Hungarian and international contexts. And, during the primary research, we have collected data about whether the undertaking serving as the basis for the research is suitable for playing the role of sample enterprise in the model. Furthermore, we have investigated the costs and returns of building up a franchise network.

First of all, we have analysed the system, operation and structure of the franchise networks so that such a private label franchise network can be established which is unique on the Hungarian market. Several

catering franchise enterprises are operating – it is enough to think of McDonald's, Burger King or other fast food chains but, of course, Fornetti can also be mentioned which is perhaps one of the best-known franchise networks in the country.

Franchise system overview

Franchise is a one- or multi-operator complex system-based form of enterprises. Its base is the franchisor or system administrator possessing the technology, know-how of the production or service, or we can just simply name him/her transferor. The transfer is possible in different structures, as a multi-franchise recipient, multi-brand recipient or a master recipient – the first option is authoritative in this case. Existence of an advocacy organization is essential for the secure operation; this is the role of the Hungarian Franchise Association which was established in 1991 in order to bring together and represent the Hungarian franchise enterprises. Its European equivalent is the European Franchise Federation (EFF) which started its operation in 1972 and it brings together the European franchise associations. It means a joint advocacy organization and its task is to popularize and support the franchise systems in Europe. It has currently 22 members, including the most significant EU member states and three non-EU members i.e. Switzerland, Turkey and Serbia. Data being in the report of August of 2015 prepared by EFF apply to 23 EU countries' period between 2007 and 2014. In the period between 2007 and 2014, Poland has the first place based on the growth rate of number of franchise brands; in this country, the number of franchise brands has more than doubled during the seven years examined. This was followed by Sweden (100%) and Belgium (75%). These countries were able to perform outstandingly. Compared to them, Hungary was exactly situated in the lower half of the middle range, with a 9.4-percent increase (European Franchise Federation).

“Franchising is a leading sector of the USA and the world. According to the International Franchise Association (IFA), 750 thousand franchise enterprises operate in the area of the United States and these undertakings provide jobs for more than 15 million American citizens. Franchising covers almost 50% of retail sales which includes the sales of automobiles and fuel as well.” (European Franchise Federation).

The appearance of the ice cream in the system as product

Theoretically, we would insert the examined enterprise as a sample business and the ice cream as a product in this franchise system.

Euroglaces is the advocacy organization of the European ice cream industry which supports the variety and diversity of this industrial sector in a close cooperation with its members, it is committed to achieving the objectives and it is responsible for the members.

The accumulated knowledge and experience make the activities of Euroglaces effective which are provided by the joined members and which cover the whole sector. The association investigates and analyses the food safety, quality, physiological effects and components of ice cream products as well as the publication of customer information. The European Ice Cream Association represents the international association via its network – it also represents small, medium and big companies all over Europe. Euroglaces is active in all matters related to the ice cream with special regard to the regulations and it is also concerned in food safety respects. Its aim is to protect and promote the European ice cream industry.

Today, 3 or 4 litres of ice cream per capita are annually consumed in Hungary and the estimated consumption of ice is less (Selden – Gipson – Parker, 2008). The Hungarian consumption of ice cream lags behind the Western European countries (Table nr. 1). According to the fact-finding of the German Markeneis, the ration is 12 litres per year in Finland, 6 litres per year in Germany and France as well as 6.1 litres of ice cream per capita are annually eaten in Italy. Another interesting thing is that the population consumes the most ice cream in Norway and Sweden so in countries with a cold climate (NÉBIH, 2016).

Building the Ice-cream franchise

“Focus and ability of an organization can be interpreted in two dimensions: strategy and implementation.” (Jenei, 2012)

Next, I will strive to examine these two issues. The basis of networking is the elaboration of business conception of the franchisor possessing the technology and know-how of the production of service. It is important to take into consideration a developed and tried business. Later, this turnkey conception shall be sold to partner enterprises.

The first and most essential step for building a franchise network is to elaborate the own brand and own image. It is important to use legal instruments and to protect the brand to be elaborated. In case of an expansion abroad, the brand should also be protected abroad; it can be carried out at national industrial property offices at union level or outside the EU.

The sample business provides important experiences for the system administrator because the imperfections of the system will emerge before those ones would cause problems for the partner enterprises later.

The appearance of seasonality in the sector

The in-year distribution of ice cream and ice purchases reflects a strong seasonality (Table nr. 2). The domestic consumption of ice cream is typically depending on weather conditions so it is no coincidence that the demand for ice creams is larger in hotter summers (Selden – Gipson – Parker, 2008). With this in mind, more ice creams should always be produced in the summer months but the aim of an enterprise is to put such a popular product in commercial circulation for which a solvent demand exists at every stage of the year. Thus, I also approach to these fluctuations of demand from a less contrasting perspective. Seasonality is a typical feature of tourism (for economic reasons mainly) which is tried to distribute in time and space by means of manifold tools (new products, favourable prices, powerful promotion) (Harpst, 2010). Ice cream is a seasonal product therefore its turnover also follows the trend corresponding to weather. In the following table, we demonstrate the effect of seasonality on the production that we have determined based on the enterprise examined, expressed in kg/month (Puczkó, 2009).

Establishing economic viability

Many reckon the profit-and-loss statement as the most important report since it shows how effective the activity of a company is. The extent of sales and the multitude of expenditures can be viewed as well as the difference of these two ones shows the profit or sometimes the loss. We have carried out the analysis based on the balance sheet and profit-and-loss statement of Fagyi-Mánia Kft. in the reporting period of 2013 and 2014.

Value of the net working capital was HUF 2 353 thousand in case of Fagyi-Mánia Kft. which has tripled in the following year i.e. it has closed the year of 2013 on a value of HUF 6 721 thousand.

The liquidity indicators measure that ability of enterprises and how they can fulfil their current liabilities. In order to judge the liquidity of an enterprise well, it is expedient to calculate more liquidity indicators and to estimate them collectively in a complex way (Table nr. 3).

Higher indicator values indicate that the enterprise will expectedly be able to fulfil its current liabilities in the future and to finance its operating costs. And, lower values of the indices can predict that the enterprise may have difficulties in fulfilling its current liabilities in the near future which can cause problems in the company operation.

In the next table, we have illustrated the general liquidity ratio and acid test ratio.

Value of the general liquidity ratio is ideal if it takes a value between 1.3 and 1.7. In the present case, the general liquidity ratio of Fagyi-Mánia Kft.

was above the specified values in both years so a solvency problem may not arise on that basis but it is worth rethinking the financial strategy in order to work more effectively.

After that, I have sought after the answer to the results of acid test ratio which compare the stocks as current assets without the least liquid assets to the current liabilities of an enterprise. In case of this indicator, the growth is advantageous, too. The expected minimum value of this indicator is 0.8-1.0. Based on my calculations, the enterprise was able to reach this minimum value every year which largely exceeds the expected value.

Profitability indicators

The profitability indicators give an answer to the question of how well the enterprises use their resources in order to produce profit and shareholder value as well as how effective an enterprise is in producing results from its resources (Table nr. 4).

The operating profit margin (ROS) of Fagyí-Mánia Kft. greatly improved in 2013 compared to the year of 2012 which was also good. A low operating profit margin means that a company does not produce sufficient income compared to its costs or its costs are not under appropriate control or both. This is not the case now. This kind of indicator called indicator of Return On Sales as well. That company is beneficial from the point of view of an investor whose indicator of this kind is above the industry average and shows an improving trend. Consequently, this exists in the present case.

Costs of the franchise partners

So, when we examine how suitable a sample shop is for operating in franchise system and how far it is worth for the outsiders to enter this system, we pre-eminently have to investigate how the costs of entrants evolve.

Costs of a franchise recipient can be divided into two groups:

- One-off costs related to the reception of the system
- Continuous system maintenance cost.

We would like to present in detail the evolution of costs by taking out certain segments of the calculation.

Establishing a business premises

One of the most essential elements of launching an enterprise is to establish the business premises. Not only the image itself but also localization of the premises will have to reflect the profile of the undertaking. It is very important that the chosen unit should be in the city centre as much as possible since the busier place the shop is established, the

more likely it is that the shop will produce sufficient profit.

The following points can be considered normative at establishing a business premises:

- Right to establish and operate the ice cream parlour at the location concluded in contract and in accordance with the image,
- Right to use the know-how and recipes concerning the ice cream parlour,
- Right to use the trademarks concerning the ice cream parlour.

Ice cream maker workshop

The workshop shall comply with all the health and other rules and shall possess authorizations. The system administrator prescribes what types of machines are punctually allowed for production since it largely influences quality of the end-product.

Initial stock

In the life of an enterprise, the initial stock also appears as a one-off cost. Production cannot be carried on without stock. Purchasing the initial stock can be a greater expenditure of the enterprise since it probably does not possess any stock. In order to launch the production smoothly, a raw material stock of almost HUF 1.5 million is required.

Brand fee

This is a one-off payment for the user charge of trademark. Every new entrant is obliged to pay it, the turnover commission will take over this role later; this commission takes its share of sales generated by the brand. This fee means an expenditure of HUF 100 thousand for the partner.

Royalty

The partner shops will pay the system administrator this kind of fee on their net turnover. This fee includes the right to use the trademark, the method required for the production and sales of the product i.e. the know-how, the organization and coordination of the supply of goods as well as the support for the continuous purchases of goods. This cost will arise monthly in budget of the partner enterprises and they have to pay the system administrator an amount equal to 5% of their net turnover. If it happened in the ice cream parlour of Fagyí-Mánia Kft. named Dolce Vita then the system administrator would expect an annual turnover commission of HUF 2 million 200 thousand based on the balance sheet data of 2013. If only ten partners of this kind joined the network then annual revenue of HUF 22 million could be realized only from that the enterprise works under one brand.

Marketing fee

The marketing fee works as a kind of supplementary budget by the system administrator who wishes to finance the network marketing from this fee. I have determined this amount in fixed monthly HUF 30 thousand. The system of marketing fee will be able to operate most effectively if more and more partners join the network which, in future, may even be enough for that the franchise network can be advertised on nationwide television channels.

Pay back period of the investment

According to our calculations, the launch of a new ice-cream costs HUF 13 million approximately. Payback period of the investment costs could be calculated by means of balance sheet of the sample shop. The earnings after taxes of Fagy-Mánia Kft. was HUF 2 025 thousand in 2012 and this amount was HUF 7 845 thousand according to data of 2013. This means that the result of Fagy-Mánia Kft. was HUF 9 870 thousand based on data of two years. If we average the results of two years then we will obtain HUF 4 935 thousand so there is a good chance that our investment will be refunded in the third year of the operation. We can perform these calculations by means of ROI indicator as well. ROI shows the efficiency of our investment (Table nr. 5).

The results and ROI indicator of Fagy-Mánia Kft. outline that the payback of investment was 15% in 2012 while the indicator reached 59% in 2013 which means a 37-percent annual payback on average. This is an excellent result since the investment will actually be refunded therefore a 3-year payback period can be predicted based on these data.

CONCLUSIONS AND PROPOSALS

Ice cream industry is extraordinarily profitable but seasonality strongly influences its operation. This effect exists simultaneously as positive and negative effect. Turnover is boosted in summer but it regresses in winter so much that it is better to close the shop and to open it after a long period of time i.e. in spring if the location of business premises is not so good. But, in large busy shopping centres, it may be worth being open in winter as well because, despite the cold weather, the other shops have so large attractiveness that generates such a demand which can ensure enough sources of income for an enterprise. However, a winter cessation should be thought over in case of a shop situated at a less popular place.

The analysis of balance sheet and profit-and-loss statement has revealed that the examined enterprise operates successfully and effectively. The product having high value added can be sold with high

margin which enhances the efficiency indicators further. Based on ROI indicator, it can be said that the investment is highly effective providing a value being well above the bank interest in percentage so we can say that it is worth investing our money in an enterprise of this type.

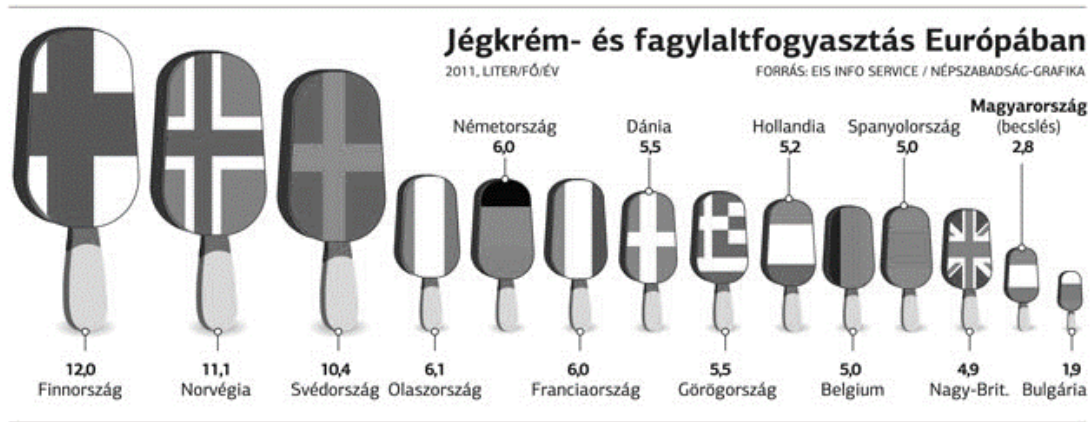
Efficiency of an enterprise would increase further by developing the financial strategy and providing further trainings. In the course of further trainings, the modern up-to-date techniques can be acquired. In life of an enterprise, it is always worth seeking after opportunities for further progress and, based on data of the enterprise examined, it can be said that Fagy-Mánia Kft. as sample shop would be able to operate perfectly thus the establishment of franchise system is highly recommended in our opinion.

REFERENCES

- [1.] Bajmócy Z. - Lengyel I. - Málóvics GY.: Regionális innovációs képesség, versenyképesség és fenntarthatóság. JATEPress, Szeged, 2012
- [2.] www.portfolio.hu: Itt a 750 milliárdnyi gazdaságfejlesztési pályázat menetrendje! 2015, URL: http://www.portfolio.hu/unios_forrasok/palyazatok/itt_a_750_milliardnyi_gazdasagfejlesztési_palyázat_menetrendje.211883.html
- [3.] European Franchise Federation: Franchise Statistics Europe 2015, URL: <http://www.eff-franchise.com/Data/FRANCHISE%20STATISTIC%20-%20EUROPE%20-%20source-EFF.pdf>
- [4.] Selden, A. C. – Gipson, R. C. – Parker, A. B. (2008): An introduction to franchising, Minnesota Department of Employment and Economic Development, Minneapolis, 83 p.
- [5.] Nemzeti Élelmiszerlánc-biztonsági Hivatal, 2016 URL: http://nebih.gov.hu/akadalymentes/aktualitasok/hirek/archivum/2012/07_24_fagylalt_jegkrem_taj.html?pagenum=1
- [6.] Jenei M.: Nagy hőségben nincs túl drága fagylalt. 2012, URL: <http://index.hu/gazdasag/magyar/2012/08/18/fagylalt/>
- [7.] Harpst, G.: Vállalkozásból vállalat, HVG könyvek, Budapest 209 p., 2010
- [8.] Puczkó L.: Turizmus és környezet. Turizmus vagy környezet? Ph.D. értekezés Budapesti Közgazdaságtudományi Egyetem, Budapest 1999

Annexes

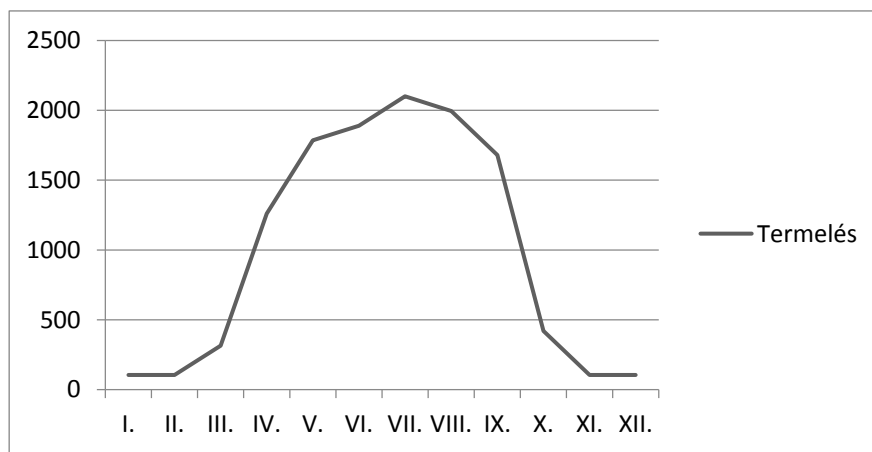
Table nr.1.



Ice-cream consumption in Europe

source: Eis Info Service

Table nr.2.



Szezonalitás hatása a termelésre
(The effect of seasonality on the production)

source:own construction 2015

Table nr.3.

Likviditási mutatók (Liquidity indicators)		
Fagyi-Mánia Kft.	2012	2013
General liquidity ratio	4,59	8,74
Acid test ratio	2,78	6,40

source:own construction 2015

Table nr.4.

(Profitability indicators)

Fagyi-Mánia Kft.	2012	2013
ROA	54,92%	66,83%
ROE	66,94%	66,83%
ROS	7,67%	17,92%

source: own construction 2015

Table nr.5

(Return on investments)

ROI	2012	2013	átlag
Fagyi-Mánia Kft.	15%	59%	37%

source:own construction 2015